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SUBJECT: 2005 INVESTMENT CLIMATE STATEMENT FOR VENEZUELA

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[1](#)1. (U) Per Reftel, the 2005 Investment Climate Statement for Venezuela is presented below.

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2005 Investment Climate Statement for Venezuela

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Statement

[1](#)A. Openness to Foreign Investment

Venezuela officially encourages foreign investment and provides equal treatment to local and foreign companies though the overall environment is in fact considerably less

welcoming. Capital repatriation is allowed (subject to exchange control restrictions described below) and there are few formal restrictions on investments except for several sectors that are reserved to the State or Venezuelan nationals such as oil production, and hydropower generation (with some exceptions).

Venezuela's economic performance had been negative for several consecutive years until 2004 when the economy showed sharp growth, though admittedly from a much lower base. GDP in 2004 expanded by 17.2 percent. Considering, however, that real GDP decreased by 7.6 percent in 2003 and by 8.9 percent in 2002, a large percentage of the strong expansion can be attributed more to the lower starting point rather than to organic growth. Inflation for 2004 was 19.2 percent and is expected to reach 15 percent in 2005. A strong recovery in global oil prices, increased tax revenue collections, and a strong overall economic recovery have been positive developments.

Statements by President Hugo Chavez and other Venezuelan officials about the need to adopt a new non-capitalist economic model (what President Chavez calls "Socialism of the 21st Century"), the takeover by individuals of some rural lands and an aggressive adoption of a "land reform" program at the state and national levels, the passage of legislation which has expanded the Supreme Court, with the subsequent appointment of judges on what observers consider a political basis rather than merit, and a sudden shift in petroleum royalty policies have been negative developments. The Venezuelan government has also sought to promote an increasing state presence in areas of the economy previously left to private enterprise. The most prominent is its "Mercal" chain of food stores aimed at low income Venezuelans, which is supplied by state purchases of commodities. Other areas that the Venezuelan state is reentering include civil aviation, telecommunications, cement production, paper manufacturing, and sugar refining.

In early 2003, President Chavez created an Exchange Administration Board (CADIVI) to regulate the purchase and sale of foreign currency. At first, CADIVI was unable to process foreign currency requests efficiently and was only supplying currency to about 15-20 percent of approved authorizations. Over time, the system has improved, and the supply of foreign currency reached a level of approximately \$15 billion in 2004, or 55 percent of approved authorizations. A number of goods have also been added to the list of imports eligible for foreign exchange including intangibles such as services and the repatriation of capital, which totaled \$1.5 billion at the end of the third quarter. There continue to be delays with pre-inspection companies thereby increasing storage costs. Although the number of approvals has increased sharply, the backlog in liquidations puts significant constraints on imports which accounted for 68.5 percent of requests, followed by private foreign debt with 12.5 percent and foreign investments with 8.6 percent. Exchange control authorities have repeatedly said that the exchange control system will be eased but will remain a permanent long-term mechanism. As of now, the system remains highly discretionary and subject to sudden changes in its application.

In terms of direct foreign investment, a number of projects are under development or in pre-engineering stages, mainly in oil and gas or large infrastructure projects. The former are governed by either the Hydrocarbons or Gaseous Hydrocarbons laws (see section A5). These involve varying kinds of contractual relationships with state oil corporation Petroleos de Venezuela (PDVSA). As regards the latter, the preferred venture scheme has become sovereign deals or contracts between state corporations. Power, several road and railroad projects and the expansion of some production facilities for basic industry seem to be the main areas where there are projects in the pipeline. However, most of these projects have very little if any private participation at all.

-- A.1 The 1999 Constitution

The Venezuelan Constitution of 1999 treats private capital

investment as a means of promoting the development of the national economy. Article No. 299 of the Constitution recognizes private enterprise as a factor for creating sources of employment and local added value, as well as raising the standard of living of the population, within a framework of free competition. The Constitution reserves certain strategic sectors for the State such as oil activity and hydropower generation.

Article 301 of the Constitution adopts international standards for the treatment of private capital, with equal treatment of local and foreign capital. As well, as a member of the Andean Community, Venezuela has accepted the application of the Andean Decisions, although examples can be found of non-compliance.

-- A.2 Legal Framework: Decree 2095

Decree 2095 (1992) establishes the legal framework for foreign investment in Venezuela. This Decree implemented Andean Pact Decisions 291 and 292 and significantly expanded foreign investment opportunities in Venezuela by lifting most restrictions on foreign participation in the economy. Most sectors of Venezuela's economy, except those specifically noted, are open to foreign participation. Article 13 of the Decree explicitly guarantees that foreign investors will have the same rights and obligations as national investors "except as provided for in special laws and limitations contained in this Decree."

Under Decree 2095, foreign investors need only register with the Superintendent of Foreign Investment (SIEX) within 60 days of the date a new investment is made. (The exception to this general rule is the Security and Defense Law, which provides that foreigners cannot own property in certain border regions or near military installations and basic industries without written authorization of the President through the Ministry of Defense.) Foreign companies may generally open offices in Venezuela without prior authorization from SIEX as long as they do not engage in certain sales or business activities that would require registration. No prior authorization is required for technical assistance, transfer of technology, or trademark-use agreements, provided they are not contrary to existing legal provisions. Shares of foreign companies may be sold publicly.

Decree 2095 also guarantees foreign investors the right to repatriate 100 percent of profits and capital, including proceeds from the sale of shares or liquidation of the company, and allows for unrestricted reinvestment of profits. Foreign exchange is, however, still subject to government exchange controls.

Joint ventures and wholly owned subsidiaries of foreign companies are treated in the same way as Venezuelan firms. Only registration of the venture with SIEX is required. Decree 2095 imposes no limits on the amount of dividends, reinvestment, or repatriation. (The foreign exchange regime, however, has significantly affected such transfers.)

-- A.3 Limitations under Decree 2095

Decree 2095 reserves three areas of economic activity to "national companies": television, newspapers, and professional services that are regulated by national laws. A "national company" (as defined in Article 1 of Andean Pact Decision 291) is a company in which Venezuelan nationals hold more than 80 percent of the equity. Foreign capital is therefore restricted to a maximum of 19.9 percent in enterprises engaged in radio, television, Spanish-language newspapers, and professional services subject to licensing legislation (e.g., law, architecture, engineering, medicine, veterinary medicine, dentistry, economics, public accounting, psychology, pharmacy, and management). Foreign professionals are free to work in Venezuela without restriction, but must first revalidate their title at a Venezuelan university. This is not required for consulting services under contract for a specific project. The Investment Promotion and Protection Law of October 1999 maintained these exceptions and reserved sectors.

-- A.4 Areas Covered by Special Laws

The sectors that are regulated by "special laws" that supplement the Constitution include hydrocarbons, natural gas, iron ore, mining, telecommunications, broadcasting, banking, mortgages, and insurance.

-- A.5 Hydrocarbons

Venezuela's vast reserves make oil and gas its leading sector in terms of attracting foreign investment. However, foreign investment is restricted in the petroleum sector. The 2001 Hydrocarbons Law reserves exploration and production, as well as "gathering" and initial transportation and storage of hydrocarbons to the state. Under this regime, primary activities must be carried out directly by the state, by a 100 percent state-owned company such as Petroleos de Venezuela (PDVSA), or by a joint venture company with more than 50 percent of the shares held by the state. The 2001 law does, however, leave new refining ventures open to private investment as well as commercialization activities, under a license and permit regime.

The Hydrocarbons Law mandated an increase in royalty payments from 16.67 percent to 30 percent, with the possibility of a reduction to 20 percent for heavy crude projects. It also stipulated that any arbitration proceedings would henceforth be in domestic not international venues. No projects have yet been negotiated under this law.

The Hydrocarbons Law did not specifically grandfather contracts executed under earlier legislation: i.e., the 33 operating service contracts awarded for "marginal" or inactive oilfields in three rounds in the 1990's; the exploration and production profit-sharing agreements awarded in 1996; and the four so-called "Strategic Associations," joint ventures formed in the 1990's to extract and upgrade Venezuela's extra heavy oil. The Venezuelan Government argued in 2001 that no such provision was necessary because retroactive application of legislative provisions is forbidden by constitutional mandate. In October 2004, the Government unilaterally eliminated a nine-year royalty holiday ceded to the Strategic Associations, arguing that this was allowable under earlier hydrocarbons legislation.

The oil sector suffered two years of negative growth in 2002 and 2003 with a 14.2 percent contraction in 2002 and 2.1 percent in 2003. The sharp decrease was due to a two-month national strike from December 2003-February 2003 that brought production to a complete halt. In an effort to restart operations in the oil industry, the Chavez Government dismissed over 18,000 striking employees, many in management positions, of which only a small percentage have been rehired. However, oil GDP increased by 18.6 percent by the third quarter of 2004 in comparison with the same period in 2003.

The Chavez administration has played a price hawk role in OPEC. It has also begun promoting the regional development and integration of state energy companies under the name of "Petroamerica." Petroamerica would be divided into Petrosur comprising the Southern Cone, Petrocaribe comprising the Caribbean nations and Petroandina comprising the Andean nations. The stated purpose of the strategy is to gain strength in international markets by eliminating trade barriers, increasing the refining infrastructure and reducing costs.

--A.6 Natural gas

Venezuela has vast untapped natural gas reserves, estimated as the eighth largest in the world, and is promoting greater use of natural gas domestically as a clean and more cost-efficient energy source. Venezuela would like to take advantage of its reserves and geographic location to export natural gas to regional markets including the U.S. The 1999 Gaseous Hydrocarbons Law offers more liberal terms than are available to petroleum investors, and Venezuela's government has sought foreign investment to develop offshore natural gas deposits near the Orinoco delta.

The 1999 Gaseous Hydrocarbons Law opened the entire natural gas sector to private investment, both domestic and foreign. The law created a licensing system for exploration and production of Venezuela's non-associated natural gas reserves regulated by the Ministry of Energy and Mines. Natural gas that is produced in association with crude oil production remains subject to the Hydrocarbons Law. The state retains ownership of all natural gas "in situ", but PDVSA involvement is not required for gas development projects. Complete vertical integration of the gas business from wellhead to consumer is prohibited.

In 2001, Venezuela held its first commercial auction of concessions for natural gas not associated with petroleum production and successfully awarded six of eleven onshore areas it offered to bidders. In 2003 and 2003, the government licensed three exploration and development blocks in the "Deltana Platform," located in waters contiguous to Venezuela's boundary with Trinidad and Tobago. Talks continue over the development of the Mariscal Sucre offshore natural gas project, which would involve the development of an LNG facility in Guiria in the Paria Peninsula. Venezuela also recently signed an agreement with Colombia that envisions the construction of a natural gas pipeline, which initially would bring Colombian gas to Venezuela but which could later be expanded to send Venezuelan gas to Central America. Finally, more private investor interest is anticipated for future gas rounds as Venezuela focuses on export oriented natural gas projects and promising off-shore exploration areas.

--A.7 Electric power

Electric power production requires intensive investments in all stages - generation, transmission, and distribution. In Venezuela, the area that is most in need of investment is generation since approximately 70 percent of country's generation capacity is concentrated in hydro stations located in a single river basin. A drought during 2000, 2001, and 2002 raised serious concerns and highlighted the need to increase and balance generation to mitigate the consequences of droughts and grid deficiencies. Investments in hydropower generation continue however, with the incorporation of

Caruachi, a 2,280 MW dam, and plans to build Tocoma, which will supply an additional 2,160 MW to the system.

Although approximately 98 percent of the national territory receives electric service, transmission is an area that also requires intensive capital investments. Venezuela's transmission assets were developed between the 1960's and 80's. While maintenance has generally been adequate, population growth has outpaced upgrades creating transmission bottlenecks particularly in the central region of the country.

A legal framework has also been crafted to regulate the sector. Its implementation, however, has been stalled mainly over concerns about the ability of CADAPE (the national power utility) to un-bundle activities and honor contracts. CADAPE is involved in generation, transmission, and distribution of electricity and is often accused of having serious management issues and very high non-technical (commercial) losses.

-- A.8 Mining

The mining law of 1999 consolidates the provisions of the 1945 mining law with subsequent mining decrees and encourages greater private sector participation in mining activities. The mining law created the National Institute for Geology and Mining (INGEOMIN), which serves as a national information center to gather and disseminate technical and scientific data for the mining industry. The law established an inter-ministerial commission to coordinate the mining sector's development between the Ministries of Energy and Mines (now the Ministry of Heavy Industry and Mining), Environment, Defense, Finance, and Planning. It also called for a "one-stop shopping" to be created within that commission to expedite concession authorization procedures.

The 1999 law maintained the basic concession terms of the 1945 law. Venezuela's concessions remain mineral-specific,

and have a maximum 20-year authorization, which can be extended for an additional 20 years. The law lengthened slightly the exploration period from 3 years to 4 years, and the development period from 4 to 7 years.

The mining law also changed the mining sector's tax structure. The 1945 mining law required a small one-time exploration tax: a surface tax of 40 centavos per hectare for alluvial deposits and one Bolivar per hectare on veins and strata deposits and a layered royalty rate. The surface tax could not be adjusted for inflation because a fixed amount was written into the 1945 law and over time has become negligible.

The legalization of small and medium size mining operations has been viewed as a positive step toward the modernization of the sector and as a way to enforce environmental standards often violated by illegal small miners. The law, nevertheless, has been criticized for its high and variable royalties. A critical issue is a provision of Title VII that allows an exploitation tax of anywhere between 1 percent and 3 percent.

Individual mining firms have faced significant problems, and government officials have made comments suggesting that a generalized review of existing mining contracts may take place.

-- A.9 Telecommunications

President Chavez signed the Telecommunications Organic Law in 2000, replacing the antiquated 1940's era law and setting the stage for significant levels of new investment in the sector. The new law, coupled with a national telecommunications plan developed by the national telecommunications commission (CONATEL), and the November 2000 expiration of the monopoly held by CANTV on basic telephony, created a favorable climate for telecommunications investors.

Between 2000 and 2003, Venezuela received over US\$3 billion in investments in the telecommunications sector. Figures for 2004 have not been released but are estimated to be near the levels of 2003, which stood at 237 million and were the lowest they have been since the opening of the sector to private investment.

Venezuela has one of the leading wireless telephony markets in the region. Three major companies share the market: CANTV (originally state-owned, now largely privatized and 28% owned by Verizon); Telcel, (recently sold by Bellsouth to Telefonica of Spain); and Digitel (formerly a subsidiary of Italy's TIM group but being acquired by CANTV). Higher investment levels are expected in 2005 to reflect these acquisitions, estimated at US\$1.3 billion for Telcel and US\$450 million for Digitel.

EDELCA, a national utility involved in power generation and transmission and subsidiary of state-owned industrial giant,

Corporacion Venezolana de Guayana (CVG), has formed a telecommunications company, CVG Telecom, using its existing fiber-optic capabilities and rights of way. According to the government, EDELCA's fiber optic capacity covers approximately 70 percent of its grid and is interconnected to those of Colombia and Brazil. This company, it is suggested, would eventually compete with Venezuela's privately owned telecommunications providers.

-- A.10 Banking

A 1994 Banking Law (Gazette No. 4641 of 1993) opened Venezuela's banking and financial services sectors to 100 percent foreign ownership. Foreign banks may enter the Venezuelan market in one of three ways: acquisition of shares of existing commercial banks or other financial institutions; creation of a new bank or other financial institution wholly-owned by foreign banks or investors; establishment of a branch of a foreign bank or financial institution. In 2001, President Chavez passed a new Banking Law as part of the package of enabling laws. This law regulates all banks with the exception of four state-owned banks.

Applications for entry into the banking sector are submitted to the Bank Superintendency, which must seek an opinion from the Central Bank before granting authorization. The government can take into account "economic and financial conditions, general and local" (Article 11 of the Banking Law) and insist on reciprocity (Article 106 of the Banking Law) when deciding on an application for entry, but it has generally not used those powers.

Total bank assets increased from US\$ 23 billion at the end of 2003 to US\$ 25.7 billion in October 2004. Since late 1996, seventeen banks have received authorization to become universal banks. Citibank is currently the only U.S. bank operating branches in Venezuela.

In 2001 a Merger Law was passed, aimed at strengthening the financial sector by allowing stronger banks to acquire weaker institutions. Since the law was passed, 13 mergers have occurred reducing the number of small banks by twenty. By November 2004, the Venezuelan financial system consisted of 17 universal banks; 15 commercial banks; 2 development banks, 5 investment banks; 2 mortgage banks; 1 leasing company; 3 savings and loan associations; 2 money market funds; 4 special law-regulated banks. Of the 51 financial institutions 43 are private and 8 are national entities.

The banking system is increasingly required to direct credit to borrowers in accordance with government requirements such as the imposition of a minimum amount of lending to be made to small businesses and farmers and a cap on mortgage interest rates.

-- A.11 Insurance

Venezuela's Insurance and reinsurance sector was opened to 100 percent foreign ownership in 1994. A subsequent decree passed on November 2001 (Official Gazette No. 5.553) establishes rules for contracts as the basis for insurance activity, detailing rights and obligations to guarantee equilibrium and protect customers. Foreign investors may acquire shares of an existing insurance or reinsurance company or create an entirely new company. Applications for entry into the sector are submitted to the Insurance Superintendency for authorization. Foreign insurance companies are prohibited from offering insurance contracts fulfilled outside of Venezuela, unless the premiums become part of the net worth of an insurance company operating within Venezuela.

-- A.12 Privatization

The GOV has a Privatization Law (Gazette No. 5199 of 1997), which allows for the privatization of public assets. A number of assets were bundled and earmarked for privatization in the early and mid 90s. From 1990-1998 FIV, the Investment Fund of Venezuela, the entity in charge of selling the assets and later renamed the Economic and Social Development Bank (BANDES), privatized over 40 entities and generated cash receipts of nearly \$4.8 billion. Foreign investors purchased stakes in the telecommunications, electricity, steel, sugar refining, tourism, dairy, cement and aviation sectors.

The Chavez Administration has shifted its policy away from selling a large portfolio of assets toward forming strategic alliances, particularly in the form of contracts with state-owned enterprises of other countries. Participation in strategic associations regarding state owned entities is coordinated and administered by BANDES. Although it has not rolled back any privatizations, the Government of Venezuela has created new state enterprises in aviation and telecommunication--areas from which the state had previously exited.

1B. Conversion and Transfer Policies

Foreign investors in capital markets and foreign direct investment projects are guaranteed the right to repatriate dividends and capital under the Constitution. However, the Law Governing the Foreign Exchange System (Gazette No. 4897

of 1995) permits the executive branch to intervene in the foreign exchange market "when national interests so dictate."

After a steep decline in the value of the national currency (the Bolivar) following a two-month general strike that brought oil production to a near standstill, the Central Bank of Venezuela halted trade in Bolivars on January 22, 2003. President Chavez announced the creation of an Exchange Administration Board (CADIVI) on February 5, 2003 to regulate the purchase and sale of foreign currency. During much of 2003, CADIVI was unable to process requests for authorization of foreign exchange in an efficient and timely manner and only supplied \$3.6 billion or approximately two months worth of transactions. There has been significant improvement over time. The supply of foreign currency reached a level of approximately \$15 billion in 2004, or 55 percent of approved authorizations.

A new CADIVI resolution allows importers to ship products without pre-approval by the government. There continue to be delays with pre-inspection companies, which increases storage costs. Although the number of currency certificate approvals has increased sharply, operating with a 50 percent backlog in liquidations puts significant constraints on imports which accounted for 68.5 percent of requests, followed by private foreign debt with 12.5 percent and foreign investments with 8.6 percent. Exchange control authorities have repeatedly said that the exchange control system will be eased but will remain a permanent long-term mechanism. Nonetheless, the quasi-legal parallel market remains an important source of foreign exchange.

A number of goods have also been added to the list of imports eligible for foreign exchange including intangibles such as services and the repatriation of capital, which totaled \$1.5 billion at the end of the third quarter. Decree 2095 guarantees foreign investors the right to repatriate 100 percent of profits and capital, including proceeds from the sale of shares or liquidation of the company, and allows for unrestricted reinvestment of profits. Legislation is pending in the National Assembly that would impose criminal penalties for financial transactions made outside of CADIVI's channels. This is a subject of significant concern within the business community given the discretionary and irregular nature of CADIVI approvals.

1C. Expropriation and Compensation

There have been several cases which raise significant issues of expropriation and/or serious impairment of the value of foreign investments in the Venezuelan state. One case relates to INTESA, a joint venture formed between Science Applications International Corporation (SAIC), a U.S. company, and Venezuela's national oil corporation PDVSA, to provide information technology services to PDVSA. PDVSA provided INTESA with a five-year service contract that it decided not to renew in 2002. INTESA continued to provide services under a provisional agreement while the parties discussed termination of the joint venture. The national strike then intervened in December 2002. The national government took over INTESA claiming the firm had not allowed non-striking PDVSA personnel to restart operations by denying access to key control systems. SAIC's interest had been insured by the Overseas Private Investment Corporation (OPIC) which determined in July 2004 that an expropriation had occurred. It paid compensation to SAIC and has in turn sought repayment from PDVSA.

Another case is related to a joint venture between Williams, a U.S. corporation, and Canada's Enbridge Corporation to operate an oil-loading terminal in Venezuela's Jose Industrial Complex. Venezuelan authorities seized control of the facility in December 2002 during the national strike, claiming that the terminal was of strategic importance and that the company, which had declared force majeure, had joined the strike. PDVSA subsequently refused to negotiate compensation for the termination of the contract. The matter is currently before an international arbitration panel and a ruling is expected shortly.

President Chavez has recently issued a controversial decree aimed at expropriating idle land for agricultural purposes as part of the agrarian reform spelled out in a 2001 law. The decree sets up a commission to inspect farmland and decide whether or not to expropriate the land holdings based on a finding that the land is not being put to adequate use or

that the owner is unable to show legal title to the land. If ownership can be proved, compensation is to be provided. However, land titles in Venezuela are not always clearly documented, and there are serious concerns regarding the process and the amount of discretion granted to the investigating authorities. In March 2005, the Venezuelan Government nationalized nearly half of the 13,000 hectare British-owned El-Charcote cattle ranch in the central Venezuelan state of Cojedes.

A 1998 land census found that 60 percent of all Venezuelan farmland was owned by less than 1 percent of the population. The census also noted that over 80 percent of the farmland redistributed during a 1960 land reform had returned to large landowners. More than 80 percent of Venezuela's population lives in rural areas.

D. Dispute Settlement

Venezuela's legal system is accessible to foreign entities seeking to resolve investment disputes. While the legal system is often slow, inefficient, and has been accused of corruption and politicization, foreign entities have not generally been discriminated against in legal proceedings. While not common, Venezuelan law allows the filing of criminal charges in some commercial disputes.

Decree 2095 allows for the arbitration of disputes as "provided by domestic law." The Commercial Arbitration Law (Gazette No. 36,430 of 1998) eliminated the previous requirement for judicial approval of arbitration. Arbitration agreements involving national or international firms can be automatically binding.

The Commercial Arbitration Law also allows state enterprises to subject themselves to arbitration in contracts with private commercial entities, but requires that they first obtain the approval of the "competent statutory body," as well as the "written authorization" of the responsible minister. In the case of PDVSA, for example, the Ministry of Energy and Mines issued a blanket written authorization in 1998 which allows the company to enter into such arbitration agreements, as it deems convenient or necessary. However, the 2001 Hydrocarbons Law prohibits PDVSA from entering into agreements providing for international arbitration.

E. Investment Incentives and Performance Requirements

-- E.1 Investment Incentives

Investment incentives take the form of tax credits, income and wholesale tax exemptions, exemption from customs duties, and some tax rebates for selected sectors in the economy. Incentives to encourage production for the export market are available to both domestic and foreign companies.

Article 45 of the Value-Added Tax Law (Gazette No. 5341 of 1999) gives the tax agency, SENIAT, the authority to grant investors exemption from VAT levies if they are engaged in new industrial projects in the pre-operative stages of development. The exemption can last up to five years or until the pre-operating period terminates, with the possibility of extensions.

Exporters may make use of special customs procedures aimed principally at raising the competitiveness of non-traditional exports by the suspension or refund of duties on imports that local producers incorporate into their export production. Mechanisms include temporary admission for inward processing, drawback, and replenishment of inventories, in-bond warehousing, and refund of the wholesale tax. The drawback

mechanism has been accused of being lengthy, and bureaucratic.

Decree 1217 (Gazette No. 35,907 of 1996) updated the norms for debt-for-equity swaps to provide incentives for new direct foreign investment entities and reduce Venezuela's external debt stock. The decree expanded the use of this instrument for a wide range of sectors: agriculture; industrial production or high technology services; petrochemical, coal, processed wood, wood pulp and its byproducts production; production and acquisition of capital goods and services; tourism; and construction of houses, medical facilities, or other structures related to social welfare interests.

-- E.2 Performance Requirements

In any enterprise with more than 10 workers, foreign employees are restricted to 10 percent of the work force, and Venezuelan law limits foreign employee salaries to 20 percent of the payroll. The state oil company, PDVSA, seeks to

maximize local content and hiring in its negotiations with foreign hydrocarbon investors.

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F. Right to Private Ownership and Establishment
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There are no legal limits on foreign ownership, except as noted in Decree 2095 and in "special laws" (see above).

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G. Protection of Property Rights
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-- G.1 Real Property Rights

Foreign investors may pursue property claims through Venezuela's legal system. While the legal system's procedures are lengthy, judgments are uneven, and allegations of corruption and politicization are common, there is little evidence that the legal system discriminates against foreign investors.

-- G.2 Intellectual Property Rights

Venezuela is a member of the World Intellectual Property Organization (WIPO). It is also a signatory to the Berne Convention for the Protection of Literary and Artistic Works, the Geneva Phonograms Convention, the Universal Copyright Convention, and the Paris Convention for the Protection of Industrial Property. Through Andean Community Decision 486, Venezuela has ratified the provisions of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

The Venezuelan Industrial Property Office (SAPI) leaves much room for improvement, and its actions and occasional publicly stated antagonism towards IPR often draw criticism from IPR advocates and rights holders. Protection of IPR is also hindered by the lack of adequate resources for the Venezuelan copyright and trademark enforcement police (COMANPI) and for the special IPR prosecutor's office. Venezuela's tax agency SENIAT is promoting several measures to fight piracy in an effort to reduce tax evasion, including a new anti-piracy law and the introduction of a tax on street vendors. According to industry representatives, SENIAT seems to be a promising enforcement entity due to its better technical and financial capabilities.

Unfortunately, pirated software, music and movies remain readily available throughout the country. In the 2003 Annual Review, Venezuela remained on USTR's Special 301 "Watch List."

-- G.3 Patents and Trademarks

Venezuela provides the legal framework for patent and trademark protection through Andean Community Decision 486 and the 1955 National Industrial Property Law. Andean Community Decision 486 takes major steps towards bringing Venezuela into WTO TRIPS compliance. However, without corresponding local laws, Venezuela is not completely TRIPS

compliant. Andean Community Decision 345 covers patent protection for plant varieties.

U.S. companies remain concerned about the impact of the Andean Tribunal's 2002 interpretation of Articles 14 and 21 of Decision 486, which do not allow for the patenting of "second-use" products. Under pressure from the Andean Community and in line with some changes in leadership at SAPI, Venezuela has revoked previously issued patents. No patents were awarded in 2004 to imported pharmaceutical products. Since 2002, Venezuela's food and drug regulatory agency (INH) began approving the commercialization of new drugs which were the bioequivalents of already patented drugs, thereby denying the patent-holding companies protection of their test data. In effect, the government now allows the test data of patented drugs or those for which patents have been requested, most of which required lengthy and expensive development, to be used by others seeking approval for their own unlicensed versions of the same products.

-- G.4 Copyrights

Andean Pact Decision 351 and Venezuela's 1993 Copyright Law provide the legal framework for the protection of copyrights. The 1993 Copyright Law is modern and comprehensive and extends copyright protection to all creative works, including computer software. A National Copyright Office was established in October 1995 and given responsibility for registering copyrights, as well as for controlling, overseeing and ensuring compliance with the rights of authors and other copyright holders. Industry experts are concerned about a proposed new copyright law proposal, which would require the mandatory registry of works, reduce protection

terms, hamper distribution agreements and increase royalties.

The Venezuelan copyright and trademark enforcement branch of the police (COMANPI) continues to provide copyright enforcement support with a small staff of permanent investigators. A lack of personnel, coupled with a very limited budget and inadequate storage facilities for seized goods, has forced COMANPI to work with the National Guard and private industry to improve enforcement of copyrighted material. COMANPI can only act based on a complaint by a copyright holder; it cannot carry out an arrest or seizure on its own initiative, which leads to weaker enforcement.

Venezuela does not automatically recognize foreign patents, trademarks or logotypes, so foreign investors must be sure to register patents and trademarks appropriately and in as many categories as are applicable. It is advisable not to have agents or distributors do this in their name because the agent can then claim that he/she is the registered owner of the trademark in question.

----- H. Transparency of the Regulatory System -----

-- H.1 Legal Environment

The Government of Venezuela adopted three laws in the early 1990's to promote free market competition and prevent unfair trade practices: an Anti-Trust Law (Gazette No. 34,880 of 1992), an Antidumping Decree (Gazette No. 4,441 of 1992), and a Consumer Protection Law (Gazette No. 37.390 of 2004).

Venezuela also passed a government procurement law that came into effect in 2001. The law supposedly increases transparency in the competitive bidding process for contracts offered by the central government, national universities, and autonomous state and municipal institutions. Despite this legal framework, there is little transparency in Venezuela and many contracts are awarded without open competition.

-- H.2 Tax Treatment of Foreign-Owned Firms

All companies and individuals are required to register with the national tax authority (SENIAT). Income received from any economic activity carried out in Venezuela is subject to taxation.

There are several different corporate tax regimes to which foreign investors could be subject, depending upon the type of economic activity in which they are engaged. Except for the petroleum sector, the current Venezuelan income tax law does not differentiate between foreign-owned and Venezuelan-owned firms. The income tax rate is progressive based on income, ranging from 6 percent to 34 percent. Companies involved in hydrocarbon and related activities pay 50 percent, except associations formed under the Hydrocarbons Law, which receive a different treatment. Companies involved in mining pay 60 percent. The Business Assets Law imposes a one percent tax on business assets (Gazette No. 4654 of 1993). The assets tax is assessed on the gross value of assets (with no deduction for liabilities) after adjustments for depreciation and inflation.

Venezuela has international double taxation agreements in the areas of air and sea transport with several countries, including the United States. A US/Venezuelan treaty to avoid double taxation went into effect on January of 2001.

SENIAT is undertaking a very aggressive tax collection program called "The Zero Evasion Plan" which has boosted fiscal revenues in 2004. Highly publicized raids have taken place and businesses, including multinational firms, have been temporarily closed administratively. Firms subject to these measures complain that these closures have been imposed for minor paperwork violations as opposed to actual tax evasion.

In 1999, the government replaced the wholesale tax (ICVSM) with a value-added tax (IVA). The value-added tax rate is currently 15 percent.

A Bank Debit Tax (BDT) was also implemented last year levying all bank transactions. Since its implementation rates have varied increasing from 0.75 percent to 1 percent at the end of 2002, and then decreasing again to 0.5 in 2004 where it currently stands.

----- I. Efficient Capital Markets and Portfolio Investment -----

-- I.1 Capital Markets

Access to the Venezuelan secondary capital market is relatively easy, and U.S. firms essentially enjoy treatment

equal to that of domestic firms. Foreign companies may issue common and preferred stocks, bonds, and other securities in Venezuelan capital markets. Foreign investors may also buy shares directly in Venezuelan companies or on the stock exchange.

The Caracas Stock Exchange (CSE) is a privately owned corporation in operation since 1947. Trading on Venezuelan stock exchanges is thin and highly concentrated. The Venezuelan Futures and Options Clearinghouse (CACOFV), the first market of its kind in the country, started operations in Caracas in September 1997. Membership in local capital markets is open to both individuals and legal entities.

A Capital Markets Law came into effect in September 1998 (Gazette No. 36,565 of 1998). It gives autonomy to the National Securities Commission (CNV) and provides regulations for intermediaries, establishes new conditions for public offerings, enhances the transparency of brokerage operations, and makes regulations more flexible for small firms that wish to issue stocks.

The Congress passed the Collective Investment Companies Law (Gazette No. 36,027 of 1996) to foster the development of Venezuela's capital market through the creation of collective investment companies. The law, which is designed to make capital market investments more attractive for small and medium investors, opened the door to the establishment of mutual funds, collective investment venture capital companies, and collective real estate investment companies. CNV issued capital requirements for collective investment companies in 1998 (Gazette No. 36,027 of 1998). Despite the

relatively advanced legal regime, Venezuela's capital markets have shrunk in size over the last decade, a reflection of economic stagnation.

-- I.2 Credit Markets

The Venezuelan financial system recovered strongly from a crisis in the mid 90's that caused the failure of a number of institutions. Banks tend to register higher profits than those in other countries in the region. Much of this is attributable to exchange controls which limit the ability of the owners of capital to transfer it outside of the country. The purchase of several troubled banks by large foreign banks also injected much needed capital, technology, and competition into the sector. Foreign banks have also taken a minority interest in several other local banks. Consequently, foreign banks now control approximately 40 percent of all banking sector assets. Venezuelan banks have become increasingly dependent on the public sector as a borrower. It is currently estimated that approximately 50 percent of banks' investment portfolios is made up of government debt.

Financing is available from a variety of sources and does not discriminate against foreign investors seeking access to credit. Banks cannot lend more than 10 percent of their assets to any one borrower.

A major concern for the financial system is the recent agricultural and housing mortgage legislation, which forces banks to lend a percentage of their portfolio at preferential rates fixed by the local authorities. The percentage of the portfolio to be dedicated to agricultural loans is currently fixed at 16 percent. The percentage for mortgages has not yet been established it is expected to be around 15 percent. These loans are of concern because the mandated rates are well below market rates and below the fairly high Venezuelan inflation rate (19.2 percent in 2004).

J. Political Violence

No major incidents were confirmed against foreign-owned or operated companies, projects, or installations in Venezuela in 2004.

K. Corruption

Corruption is a serious problem in Venezuela. Venezuela has a regulatory system to prevent and prosecute corruption and accepting a bribe is a criminal act. Penalties include fines and/or prison sentences. Historically, the country has lacked an effective judicial system to provide judicial security for either foreign or national residents. The new constitution also gives the central government enhanced powers to investigate cases of corruption and oversee the use of government funds.

Government tenders are the most vulnerable to corruption because the tender process frequently lacks transparency.

Critics have also targeted the current regime of government price and exchange controls as a source of corruption.

L. Bilateral Investment Agreements

Venezuela currently has bilateral investment agreements in force for the promotion and protection of investment with the following countries: Argentina, Barbados, Canada, Chile, Costa Rica, Cuba, the Czech Republic, Denmark, Ecuador, Germany, Lithuania, Netherlands, Paraguay, Peru, Portugal, Spain, Sweden, Switzerland, the United Kingdom and Uruguay. France and Belgium have signed agreements that are still awaiting legislative approval. No agreement exists with the United States.

M. OPIC and Other Investment Insurance Programs

OPIC currently has significant exposure in Venezuela, as does the Export-Import Bank. Please refer to the section on Expropriations and Compensation for information on OPIC. In April 2003 Ex-Im Bank formally placed Venezuela "off cover" for new lending where it currently remains.

N. Labor

Venezuela's total labor force (defined as all persons 15 years of age and older who are working or looking for work) was 12.2 million at the end of December 2004. According to the National Institute of Statistics (INE), 1.8 million, or 15.5 percent, were unemployed. Persons are considered as employed if they work at least 1 hour per week. Of the 10 million employed workers, approximately 47 percent work in the informal sector (i.e. as street vendors, domestics, small entrepreneurs, etc.). The government employs about 1.4 million of those who work in the formal sector.

The major labor organization in Venezuela is the Confederation of Venezuelan Workers (CTV), which represents most of the unionized workers in Venezuela. The CTV claims a membership of 3 million, although its actual membership is probably closer to one million. The CTV is especially strong in the public sector. A second union confederation the National Workers Union (UNT) has been formed and enjoys support from the Venezuelan government.

President Caldera signed landmark legislation in June 1997 (Gazette No. 5152 of 1997) to reform the outdated and unworkable severance pay system in the Organic Labor Law. The legislation was based on a framework agreement negotiated among representatives from the government, private business, and organized labor. Under the previous severance pay system, departing employees received one month's salary (two months if they left involuntarily) for each year worked based on their current pay. The 1997 system did away with "retroactivity" (i.e. basing the entire benefit on current salary) and requires employers to calculate their severance pay obligations annually and to make monthly deposits into a pension fund, an employer account, or an outside trust account.

The 1997 Organic Labor Law also provides that the minimum wage will be reviewed at least once a year and may be adjusted based on considerations such as the "food basket." A minimum wage of Bs. 321,235 (\$139) per month for urban workers and Bs. 289,111 (\$125) per month for agricultural workers took effect in August 2004.

The Organic Law Pertaining to the Integral Social Security System (Gazette No. 5199 of 1997) provides the general framework for the social security structure. Congress passed a social security reform in 1998, but the system remained under review by the Chavez government, until 2002, when the National Assembly passed the Social Security System Organic Law (Gazette No. 37600). However, the full application of this law that covers everybody that contributes or not with the expenses, will depend on the fiscal reforms.

The Organic Labor Law places quantitative and total wage cost restrictions on the employment decisions made by foreign investors. Article 27 of the Labor Law requires that the number of foreigners hired by an investor not exceed 10 percent of a company's employees, while salaries paid to foreigners may not exceed 20 percent of the total company payroll. Article 28 allows for temporary exceptions to Article 27 and outlines the requirements for hiring technical expertise when equivalent Venezuelan personnel is not available. Article 20 of the law requires that industrial relations managers, personnel managers, captains of ships and airplanes, and foremen be Venezuelan. Article 19 requires

that all orders and instructions to workers be given in Spanish.

The Venezuelan government has imposed a freeze--renewed every six months--on layoffs. Thus, reductions-in-force require the negotiation of severance packages in exchange for voluntary resignation.

10. Foreign Trade Zones/Free Ports

The Free-Trade Zone Law (Gazette No. 34,772 of 1991) provides for free trade zones/free ports. The two existing free trade zones are located in the Paraguana Peninsula on Venezuela's northwest coast (industrial) and Margarita Island (commercial). Under the law, any investor in the Paraguana industrial free zone can receive a 10-year exemption from income taxes on all profits earned from goods produced for export. The government may extend such benefits for an additional 10 years. Few investors have taken advantage of the tax breaks in Paraguana due to infrastructure problems in the region. Both the Paraguana and Nueva Esparta (Margarita Island) zones provide exemptions from most import and export duties and offer foreign-owned firms the same investment opportunities as host country firms. Venezuela has three free ports that also enjoy exemptions from most tariff duties: Margarita Island, Maracaibo and, the most recent addition to this list established in May 1999, Santa Elena de Uairen in the state of Bolivar.

1P. Foreign Direct Investment

Embassy estimates the total stock Foreign Direct Investment (FDI) in Venezuela stood at 21 billion in 2004. The United States was the single largest foreign direct investor in Venezuela, representing approximately 53 percent, followed by the Cayman Islands with 17 percent, the Netherlands with 7.5 percent and Spain with 5 percent. The percentage represented by the Cayman Islands is thought to include Chinese investments.

The stock of U.S. foreign direct investment (FDI) in Venezuela in 2003 was \$10.8 billion according to U.S. Department of Commerce statistics. U.S. FDI in Venezuela is concentrated largely in the petroleum, telecommunications, manufacturing and finance sectors.

The estimated U.S. trade deficit with Venezuela for 2004 is projected at \$19.5 billion, an increase of \$5.2 billion from the trade deficit of \$14.3 billion in 2003. U.S. goods exports to Venezuela were approximately \$4.5 billion, up \$1.8 billion from 2003. U.S. imports from Venezuela are estimated at about \$24 billion in 2004, an increase of \$7 billion from the level of imports in 2003. The large increase in imports is related primarily to the increase the price of petroleum, which represents the vast majority of U.S. imports.

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